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Backgrounder

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The Border Papers

The Canada-Mexico Conundrum:

Finding Common Ground

Danielle Goldfarb

The Backgrounder in Brief

Eleven years after its implementation, NAFTA is composed of strong Canada-U.S. and Mexico-U.S. relations, while the links between Canada and Mexico are relatively weak. The two countries have different priorities, but because they border on the U.S., they have interests in each other's security and prosperity. Canada and Mexico should not cooperate for cooperation's sake, but there are discrete areas in which they can better advance their interests by working together rather than by going it alone.

About the Author

Danielle Goldfarb is Senior Policy Analyst at the C.D. Howe Institute.

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Eleven years after the North American Free Trade Agreement (NAFTA) subsumed the Canada-U.S. Free Trade Agreement, it is clear that North America is composed of two strong bilateral relationships — Canada-U.S. and Mexico-U.S. By comparison, the Canada-Mexico relationship is weak. Canada and Mexico have to some degree each disappointed the other. Canada has not actively helped Mexico with its economic development, and Mexico has stumbled in dealing with Chinese competition, growing less robustly than expected.

As the two countries assess their places in North America and the world almost four years after the terrorist attacks of September 11, 2001, and face such new challenges as the economic emergence of China and India, are there unrealized possibilities in their relationship? Do the two countries find themselves with common national interests? Can they better advance their domestic and foreign interests, both in North America and the world, by working together rather than working alone?

In April 2005, the C.D. Howe Institute[1] brought together a small group of Canadian and Mexican decision makers and experts, as well as two U.S. experts on Canada and Mexico (Box 1 lists the participants), for an off-the-record discussion of common ground between Canada and Mexico. This Backgrounder discusses the main ideas raised in the session on a not-for-attribution basis. The discussion took place just after leaders of the three NAFTA countries met in Texas in March 2005 and announced the Security and Prosperity Partnership of North America, a plan that emerged in a more concrete form in June 2005.

Canada and Mexico have different near-term priorities in their respective relationships with the world's largest economy and only superpower. For Canada, the priority is secure access to the U.S. market. For Mexico, secure access is important, but the country is deeply concerned with legalizing migration flows and improving its anemic economic development. Perhaps reflecting these differences, and because there are no major irritants between the two countries, Canadian and Mexican decision makers and citizens pay little attention to each other, relative to other countries. This is a mistake; because Canada and Mexico share a border with the United States, they have critical stakes in each other.

Policymakers should use their imagination and vision to look beyond near-term electoral uncertainties in both countries to a longer-time horizon. Rather than seek out areas for cooperation as an end goal, there are a few discrete areas in which Canada and Mexico can better advance their interests both in their immediate region and elsewhere by working together, rather than by working alone. These could include expanding Canada's seasonal guest worker program, recognizing each other's educational credentials, eliminating withholding taxes, and cooperating on specific aspects of security, such as preventing organized crime.

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1 The Institute thanks the University of Alberta Business School for co-sponsoring the seminar, the Instituto Tecnológico Autónomo de México (ITAM) for its support of Mexican participation in the seminar, and both ITAM and the Mexican Council on Foreign Relations for their advice on Mexican participants. The author wishes to thank participants for their comments on a previous draft of this Backgrounder. Every attempt was made to capture the essence of the discussions, subject to editorial discretion.

Box 1: *Participants*

Alan Alexandroff, Fellow-in-Residence, C.D. Howe Institute and Munk Centre for International Studies, University of Toronto

Peter Boehm, Assistant Deputy Minister, Foreign Affairs Canada

Rafael Fernández de Castro, Head of Department of International Studies, Instituto Tecnológico Autónomo de México (ITAM)

Rafael Cortes, Trade Commissioner of Mexico in Toronto, Mexican Bank for Foreign Trade (Bancomext)

John Dickson, Deputy Chief of Mission, United States Embassy in Canada

Wendy Dobson, Institute for International Business, Rotman School of Business, University of Toronto

The Hon. J. Trevor Eyton, O.C., Brascan Corporation

Drew Fagan, Senior Advisor, Foreign Affairs Canada

Ana Paola Barbosa Fernandez, Second Secretary, Mission of Mexico to the United Nations

Ken Frankel, Hodsgon Russ LLP

Danielle Goldfarb, Senior Policy Analyst, C.D. Howe Institute

Gerónimo Gutiérrez, Undersecretary for North America, Secretariat for Foreign Relations, Government of Mexico

Michael Hart, Professor and Simon Reisman Chair in Trade Policy, Norman Paterson School of International Affairs, and Distinguished Fellow, Centre for Trade Policy and Law, Carleton University

Athanasios Hristoulas, Department of International Studies, Instituto Tecnológico Autónomo de México (ITAM)

Emmanuel Kamarianakis, Counsellor (Trade Policy), Canadian Embassy in Mexico

Stephen R. Kelly, Deputy Chief of Mission, United States Embassy in Mexico

Teresa de Madero, Ambassador of Mexico to Canada

Jack Mintz, President and Chief Executive Officer, C.D. Howe Institute and Deloitte & Touche LLP Professor of Taxation, J.L. Rotman School of Management, University of Toronto

Rolf Mirus, Professor and Director, Western Centre for Economic Research, University of Alberta School of Business

Maureen Appel Molot, Professor, Norman Paterson School of International Affairs, Carleton University

Reid Morden, Executive Director, Independent Inquiry Commission into the United Nations Oil-for-Food Program

Finn Poschmann, Associate Director of Research, C.D. Howe Institute

Carlos Pujalte, Consul General of Mexico in Toronto

William Robson, Senior Vice-President and Director of Research, C.D. Howe Institute

Raúl Rodriguez, Director General, North American Development Bank

Andrés Rozental, President, Mexican Council on Foreign Relations and President, Rozental and Associates

Carlos Sada, Mexican Consul General in Chicago

Brian Stevenson, University of Alberta Business School (on leave)

Gustavo Vega Canovas, Centre for International Studies, El Colegio de México

Duncan Wood, Department of International Relations, Instituto Tecnológico Autónomo de México (ITAM)

Context and Current Activities

Both countries face uncertain political situations in the near term. Any of three major parties could win the 2006 Mexican elections, but none are likely to enjoy a Congressional majority, nor pursue a North American agenda comparable to current President Vicente Fox's ambitious approach. Canada's Liberal minority government likely faces an election in early 2006, taking Canadians back to the polls for the second time in less than two years. The outcome is uncertain; it could result in another minority government.

In early 2005, the two countries' leaders met in Ottawa and again with U.S. President George W. Bush in Crawford, Texas. Officials point to considerable activity as a result. Undertakings include the Canada-Mexico Partnership — "a mechanism for identifying policy areas in which [governments] can facilitate cooperation and enhance opportunities for economic development and investment" (Government of Canada 2005) — and the trilateral Security and Prosperity Partnership (SPP). The SPP is a set of initiatives intended to improve cooperation on security, trade facilitation, environment and disease control, among other issues. Officials characterized the SPP as a major, bold advance. Others argued that it is neither very ambitious nor especially novel. In particular, it does not commit to a secure perimeter, common external tariffs, a more effective, binding dispute-resolution mechanism, or time frames for trilateral meetings. A trilateral non-governmental task force has proposed a much more ambitious vision of a North American community (Independent Task Force on the Future of North America 2005).

Though framed by governments as trilateral, the SPP allows two partners to proceed bilaterally. The June 2005 progress report on SPP initiatives (Governments of Canada, Mexico and the U.S. 2005) demonstrates that a number of activities already under way are not in fact trilateral, but are Canada-U.S. or Mexico-U.S. in nature.

What We Share and Where We Differ

To what extent do Canada and Mexico have shared interests in terms of prosperity, security, as well as in other areas, such as foreign policy?

Prosperity

Canada and Mexico share the country that boasts the world's largest economy as their neighbour. The two countries have interests in secure access to the U.S. market and in ensuring that security initiatives do not unduly harm their prosperity, as well as in eliminating regulatory differences in areas where they are similar.

Canada and Mexico also share frustration over the U.S. refusal to eliminate the WTO-inconsistent Byrd amendment that has made it difficult to resolve bilateral trade disputes. Both face the reality of China and India's economic emergence and the related need to adjust faster than the Asian countries reform, though China's

rise seems to have had a greater impact on Mexico — the maquiladora industry in particular. Both are concerned about security measures that may make the border more costly and less predictable to cross, reducing Canadian and Mexican attractiveness to investors.

Despite some commonalities, the two countries are at radically different levels of development and face entirely dissimilar barriers to their prosperity. Mexico's top priorities in North America are legalizing Mexican migrants' flows into the U.S. — an issue that became more difficult post-September 11 — and dealing with Mexico's significant economic development challenge.[2] Many Mexican commentators argue that their country is often better able to advance its interests in the U.S. by pursuing trilateral rather than bilateral Mexico-U.S. initiatives. A number of commentators pointed out, however, that for Mexico to be prosperous, instead of pursuing bilateral, trilateral or multilateral initiatives, the country must first undertake domestic economic reforms.

The top Canadian priority, by contrast, is ensuring secure, predictable access to the U.S. market, which became even more critical after the September 11 terrorist attacks. Neither migration from Mexico to the U.S. nor the country's economic development rank at the top of the Canadian radar screen. Migration is not really viewed as an issue for Canada because relatively few Mexican migrants settle there, though Ottawa would welcome greater mobility of labour in North America.

Many Canadian commentators are lukewarm to trilateral approaches because, they say, Canada and the U.S. are both more advanced than Mexico on border issues, and including Mexico could delay progress. For example, though Mexico's government says it will pursue common or similar North American external tariffs, which would enable NAFTA to eliminate origin rules, average non-NAFTA Mexican tariff rates are much higher than those in Canada and the United States.

Still, Canada has a stake in Mexico's prosperity and in its ability to respond to the development challenge because that country's economic well-being is important for regional stability and security. A prosperous Mexico is a prerequisite for regional security because illegal migrants will continue to flood into the U.S. — and make security more challenging — until Mexican citizens are able to achieve greater economic satisfaction at home.

Though a number of Mexican commentators say that both countries should pursue North American initiatives as a priority, neither Canada nor Mexico appears to have prioritized the trilateral Canada-U.S.-Mexico relationship over their relationship with the U.S. or with the rest of the world. For example, Mexico has signed a large number of bilateral free trade agreements outside of North America, including with the European Union. For their part, Canadian decision makers do not appear to feel locked in by the trilateral relationship created under NAFTA. They recognize Canada's economic, cultural and historical links with

2 A number of Mexican participants invoked the example of the European Union, which includes countries at different levels of development and allocates funds to the less-developed ones, as a place to derive lessons for North America. Canadians tend to argue that North America has its own distinct set of circumstances, including large asymmetries between the U.S. and its neighbours, and that a greater degree of political union, which is the ultimate goal of the European experiment, is of no interest in North America.

European countries as closer than ties with Mexico, and envision larger potential payoffs from economic links with Asian countries.

To be sure, despite these different views, there are a few specific areas in which Canada and Mexico could work together to realize greater gains. In terms of private-sector activity, there are some unrealized gains in Canada-Mexico trade and investment (Canada-Mexico economic relationships are highlighted in Box 2). While current trade and foreign direct investment (FDI) between the two countries is relatively low, trade data likely understate Canada-Mexico trade — and Canadian FDI in Mexico has doubled in recent years. Since the beginning of this decade, China's strong performance has resulted in Canada-U.S. trade declining as a share of both countries' overall trade; however, two-way Canada-Mexico and U.S.-Mexico trade flows are still growing rapidly (Warren 2005).

Canada's and Mexico's economies are composed differently and the greatest trade gains occur from differences between two economies, even when starting at low initial levels. There is already a lot of joint activity in the mining sector — Canada is the largest foreign investor in Mexico's mining sector — and areas of particular future interest could include manufacturing, resources, financial services, and agriculture. A related sector for potential gains is in trilateral rail or other transportation initiatives. Also, Canada's energy leaders are interested in Mexico's energy industry, though Mexico's constitution limits foreign investment in that area.

Another area for large potential economic payoffs lies in further integrating capital markets to improve efficiency. The NAFTA countries could achieve this through harmonization of financial regulation. This could include eliminating withholding taxes on dividends and interest. Canada and Mexico could eliminate withholding taxes using bilateral tax treaties, without reforming the whole tax system.[3] It might also include ensuring that dividends from shares listed on Mexican stock exchanges are eligible for tax credits (this is mainly a Canadian issue).

There are at least several other areas in which Canada and Mexico can achieve greater prosperity by working together rather than by working alone. For example, Canada's Seasonal Agricultural Worker Program employs Mexicans temporarily in Canada. The two governments could enlarge this program to include greater numbers of Mexicans and extend it to other areas of the Canadian economy in addition to agriculture.[4] For example, the program could include the energy and transportation sectors in order to fill seasonal shortages, as well as to such professions as nursing and teaching. As Canada's population ages, Mexico's relatively younger one may be able to fill Canadian labour gaps. Ensuring that Canadian provinces recognize university and college education credentials in Mexico and vice versa could also improve efficiency and prosperity in both countries.

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3 One participant noted, however, that withholding taxes are not a large inhibitor of investment between the two countries.

4 The seasonal worker program was grandfathered in when Canada signed the General Agreement on Trade in Services. If Canada expands the program to other sectors, other Canadian trade partners could arguably make the case that all workers coming into Canada should be similarly eligible for such a program.

Box 2: *Canada and Mexico: A Few Indicators*

Goods and Services Trade

Exports	
Canadian goods exports* to Mexico, 2004, C$ millions	2852
Canadian goods exports to Mexico as share of total Canadian goods trade, 2004 (%)	0.7
Mexico's rank in terms of Canadian exports to other countries	5
Canadian service exports to Mexico, 2002, C$ millions	528
Canadian service exports to Mexico, share by service category, 2002 (%)	
Travel	48
Commercial services	39
Transport and government services	13
Imports	
Canadian goods imports from Mexico, 2004, C$ millions	13404
Canadian goods imports from Mexico as share of total Canadian goods trade, 2004 (%)	3.8
Canadian service imports from Mexico, 2002, C$ millions	894
Canadian service imports from Mexico, share by service category, 2002 (%)	
Travel	77
Commercial services	12
Transport and government services	12
Investment	
Mexican direct investment in Canada, average 1999-2003, C$ millions	138
Canadian direct investment in Mexico, average 1999-2003, C$ millions	3293

Top Canadian Goods Exports to Mexico, 2004 (by 5-digit North American Industrial Classification System (NAICS) category)

Animal slaughtering and processing
Oilseed (except soybean) farming
Wheat farming
Alumina and aluminum production and processing
Railroad rolling stock manufacturing
Motor vehicle transmission and power train parts manufacturing
Iron and steel mills and ferro-alloy manufacturing
Automobile and light-duty motor vehicle manufacturing
Resin and synthetic rubber manufacturing
Other basic organic chemical manufacturing

Top Canadian Goods Imports from Mexico, 2004 (by 5-digit NAICS category)

Automobile and light-duty motor vehicle manufacturing
Audio and video equipment manufacturing
Computer and peripheral equipment manufacturing
Motor vehicle electrical and electronic equipment manufacturing
Other motor vehicle parts manufacturing
Semiconductor and other electronic component manufacturing
Motor vehicle gasoline engine and engine parts manufacturing
Office furniture (including fixtures) manufacturing
Electrical equipment manufacturing
Navigational, measuring, medical and control instruments manufacturing

Sources: Statistics Canada, Industry Canada Trade Data Online and author's calculations.

* Domestic exports.

Security and Defense

Some commentators say that Mexico and Canada have a strong interest in ensuring that the other country is secure. Overlooking such concerns could undermine each country's critical interests in security and prosperity. If either Mexico or Canada represents a security threat to the U.S., Washington will likely reflect that danger in its policies with both countries. As a result, solid security relations between the U.S. and Mexico are in Canada's interests, and strong security relations between Canada and the U.S. are in Mexico's interests. Policymakers should be aware of areas in each other's countries in which security threats may spill over into the region as a whole.

As in other areas, most Canadian commentators tend to resist including Mexico in any Canada-U.S. security or defense initiatives. They say that including Mexico could retard Canada-U.S. progress, and they stress the need to avoid a situation in which the U.S. government applies the same policies and treatment to Canada's border as to Mexico's. Most Mexican commentators argue that a trilateral approach to security and defense cooperation, or at least following Canada-U.S. initiatives with similar Mexico-U.S. ones, makes it easier to advance Mexico's security interests than pursuing Mexico-U.S. initiatives without Canada as a partner, or without a Canada-U.S. precedent.

After the 2001 attacks, Canada proposed and successfully pursued a Canada-U.S. Smart Border Accord, intended to improve scrutiny of high-risk traffic and facilitate movements of low-risk goods and people. Though Canadians tend to view the smart border initiative as a success, some Mexicans view the fact that it was negotiated first with the Canadians and then with the Mexicans to have been a lost opportunity. Some argue that it would have been preferable for Canada and Mexico to have jointly approached the U.S. on the issue and to have built a trilateral border initiative from the beginning, rather than using a dual approach.

Those different views appear to stem from current levels of U.S. defense and security cooperation with each of Canada and Mexico, as well as from the types of issues on each U.S. border. Canada has a much more mature security and defense relationship with the United States than does Mexico. Formal Canada-U.S. defense cooperation goes back about a century. Canada and the U.S. still work closely on many security and defense matters, though not all.

For Mexico's part, it signed a similar but less ambitious border accord with the U.S. shortly after the United States-Canada one, and undertook initiatives on border security, intelligence and air traffic cooperation that would have been unthinkable before the terrorist attacks. To some degree, Mexico-U.S. collaboration on monitoring air traffic is more robust than that between Canada and the United States because of privacy issues in Canada. Still, the Mexico-U.S. border is plagued by a significant migration issue that is difficult to separate from security. Military cooperation is much more advanced between Canada and the United States and Mexico's leaders have so far failed to convince their citizens of the importance even of peacekeeping, let alone North American security and defense cooperation.

These differences underline the fact that an ambitious joint security and defense initiative between Canada and Mexico, or trilaterally, is unlikely to work

or advance either country's interests effectively.[5] If policymakers aim instead at what is achievable, there are a number of discrete areas in which Canada and Mexico working together — either bilaterally or within trilateral initiatives — could better advance their respective interests. Possible areas for collaboration include ensuring the security of air, road and sea spaces, as well as attacking organized crime.

Other Areas With Potential

There may be other areas in which Canada-Mexico collaboration will yield better results than working alone. Mexican commentators point to Canadian advice to Mexico in recent years on governance and federalism. This advice and presence both helps Mexico address issues of concern and improves Canada's image in that country. Such cooperation could be expanded. Also, to boost mutual understanding, some commentators suggest mutual education programs, as well as student exchanges.

Another project that holds potential gains for both countries and could be advanced with few resources is Ottawa's sustainable cities initiative, in which Canadian businesses assess urban development needs in a Mexican city and then help address those needs.[6]

As for foreign policy, there is currently no concept of a shared North American or Canada-Mexico position, nor does there appear to be a strong rationale for, or support of, either. On specific projects, though, Canada and Mexico may be able to better advance their international interests, either inside or outside of the hemisphere, by working together. On some issues, Mexican policy positions are similar to Canadian ones. The two countries already collaborate on various issues within the United Nations, the Organization for American States, and the Organization for Economic Co-operation and Development, for example. Cooperation itself should not be the end goal, but rather a tool for advancing interests and both Canada and Mexico should ensure that international positions reinforce, rather than detract from, their North American interests.

Some Mexican participants argued that health care presents another win-win situation. Canadian governments could, for example, pay for Canadians to buy elective health care services in Mexico at a fraction of their cost in Canada, reducing the escalating costs of Canadian health care and creating infrastructure that would also benefit Mexicans.

A number of participants said that Canada could serve as a model for Mexico in some areas. This could be in both countries' interest if it improved Mexican prosperity and security, and reduced the chance of negative spillovers from Mexico to the region as a whole. One possible area for such an approach is in energy, where Canada's model allows substantial foreign investment in the oilsands and in oil and gas pipelines, while still protecting resources and

5 The Security and Prosperity Partnership update in June 2005 (Governments of Canada, Mexico and the U.S. 2005) points to a number of areas for Canada-U.S. and U.S.-Mexico collaboration and in some areas possible trilateral co-operation, but no Canada-Mexico specific initiatives.

6 This project is now part of the Canada-Mexico Partnership.

providing government revenue. Canadian expertise might help Mexicans transform their own energy sector. Similarly, the Canada-U.S. International Joint Commission that manages trans-border water issues has been successful and could serve as a good model for Mexico-U.S. cooperation. And Mexico may be able to learn from Canada's experience in the North American Aerospace Defense Command, in which Canada and the U.S. share decision-making.

Overall, in order to advance Canadian and Mexican interests in North America, leaders should develop a vision and framework of what North America could look like.[7] Being reactive, rather than having a vision, leaves the U.S. calling the shots. NAFTA country leaders should advance the Security and Prosperity Partnership though, as one participant argued, that project might be more effectively steered by outside-of-government leaders with access to senior government, business and civil society representatives. Regular meetings of NAFTA leaders would be in both countries' interests, as long as there is a positive agenda for discussion and as long as any two countries can move forward on a particular issue if the third is not ready.

Conclusion

The reality is that Mexico's and Canada's priorities in North America differ: Canadians are primarily worried about trade, Mexicans about migration. At the same time, Mexico must address a number of domestic economic problems before being able to delve deeply into Canada-Mexico, or trilateral, initiatives. Yet because the two countries border on the U.S., they have an important stake in each other's prosperity and security. At a minimum, this supports the case for increased dialogue. And while the two countries should not collaborate for collaboration's sake, there are some specific areas, such as trade, transport, capital markets, labour mobility, air and sea security, and certain foreign policy issues, in which acting together seems more likely to produce payoffs than working alone. In the longer term, if Mexico is able to address some of its development challenges, Canada and Mexico may get much closer to both a bilateral and, together with the U.S., a bona-fide trilateral agenda, rather than separate Canada-U.S. and Mexico-U.S. agendas.

7 Some participants recommended creating new institutions, such as summits and non-governmental commissions, while others argued that current bilateral and North American institutions were adequate.

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The Border Papers

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